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BEER INSTITUTE

October 21, 2003

Mr. William Foster
Chief, Regulations and Procedures
Department of the Treasury
Alcohol and Tobacco Tax and Trade Bureau
P.O. Box 50221
Washington, D.C. 20091-022 1

SENT VIA MESSANGER

Re. TTB Notice No. 4 Flavored Malt Beverages and Related Proposals

Dear Mr. Foster:

The Beer Institute appreciates this opportunity to comment on behalf of our membership on the proposed standard for flavored malt beverages, published by the Alcohol and Tobacco Tax and Trade Bureau (TTB) on March 24, 2003.2

1. Introduction

The Beer Institute believes that TTB has correctly analyzed federal law in development of the proposed standard that would limit the distilled alcohol added to a malt beverage in flavorings or other ingredients to less than 0.5% alcohol by volume in the final product. This comment is intended to provide additional background and analysis consistent with TTB's proposed approach to address developments in the marketplace over the last several years and to fulfill the Agency's ongoing efforts to

1 These comments are being filed on behalf of Anheuser-Busch, Miller Brewing Company and Coors Brewing Company. These three companies are the senior and sustaining members of the Beer Institute. They produce or import well over 75% of the beer and other malt beverages sold in the United States including many successful flavored malt beverage brands.
2 68 Fed. Reg. 14292, referred to hereinafter as Notice No. 4.

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achieve consistency in the composition and classification of flavored malt beverages. It will protect the intent of Congress and best addresses concerns of the states without blurring the historical, statutory, and regulatory distinctions that separate beer from wine or distilled spirits.

The TTB's proposed flavored malt beverage standard is the right standard because it has long term support under the law, manages state interests concerning the distribution and structure of the malt beverage industry, and protects the integrity of beer and malt beverages for future research and product development.

The alternative proposed flavored malt beverage standard that would allow up to 49% of the alcohol in a finished flavored malt beverage to be derived from distilled spirits is not the correct standard for the brewing industry. Congress and the states will not accept products sold as beer or malt beverages to be blends of alcohol obtained by distillation with addition of a malt based beverage. Allowing the practice to continue would be contrary to the traditional and important distinctions the law makes between beer and distilled spirits.

This comment supports final adoption of the following specific regulations as drafted in Notice No. 4: 27 CFR § 7.10 (incorporating the statutory definition of "malt beverage"); § 7.11 (the standard for malt beverages); § 7.31 (label approval and release); § 25.11 (restating the Internal Revenue Code definition of "beer"); § 25.15 (product standards for taxation at the beer rate); § 25.53 (samples furnished to TTB); § 25.56 (formula filing requirements); § 25.57 (information provided in a formula); § 25.58, (superceding formula requirements); and conforming changes to existing regulations found in §§ 25.62, 25.67, and 25.76. The Beer Institute proposes modifications to

§ 25.55 (formula filing requirements). The Beer Institute also supports inclusion of a separate section in Part 25 establishing the effective dates of the formal standard for purposes of regulatory and tax compliance.

The TTB proposal promotes government efficiency and stability in a heavily regulated industry and is needed to support public policies intended to establish a formal structure of the alcohol beverage distribution system and to maintain an orderly marketplace through licensing, tax collection, and business regulation at the federal, state, and local levels. Consistency in application of the law and in the marketplace is a

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legitimate public policy concern given the longstanding societal interest in closely governing commerce in alcohol beverages.

2. TTB Authority

The subject matter of this rulemaking is a category of beverages currently being produced and sold as flavored beer or flavored malt beverages under detailed interim guidance from TTB and its predecessor agency, the Bureau of Alcohol, Tobacco and Firearms. Changes are being proposed in two separate parts of Title 27 of the Code of Federal Regulations.

The Federal Alcohol Administration Act is cited as the general authority for proposed changes in 27 CFR Part 7•3 Subsections (e) and (f) of 27 U.S.C. 205 both include language specifically authorizing the Secretary of the Treasury to issue regulations to carry out the intent of Congress with respect to alcohol beverage labeling and advertising.

Citations to fifty different sections of the Internal Revenue Code as well as seven sections of Title 31 of the United States Code dealing with surety bonds are included in Notice No. 4 as authority for TTB to promulgate the changes to 27 CFR Part 25. The detailed text of the Code clearly provides the Secretary with broad authority to issue and enforce regulations, to classify products for tax purposes, and to establish a workable administrative system to collect taxes.

TTB is acting entirely within its jurisdiction over product classification, taxation, advertising, and labeling to clarify the tax and regulatory treatment of flavored malt beverages now in the marketplace. TTB officials have articulated the agency’s approach to the newer varieties of flavored malt beverages over the last eight years, and industry members have received ongoing guidance and notice of TTB’s concerns in this area. Moreover, TTB’ s proposed regulations are consistent with the interests of States. Since the 1930’s, federal officials have helped develop a regulatory system for malt beverages consistent with the unique state powers conferred by the 21St Amendment to the Constitution of the United States.

68 Fed. Reg. 14301.

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The sections below address the key statutes and aspects of federal policy supporting TTB's proposed "less than 0.5% standard." Comments are also provided on the text of the regulations proposed in Notice No. 4 and whether they are the most practical and efficient means of addressing broad Congressional concerns over beer advertising and labeling, as well as protection of federal revenue.

3. The Proposed "Less than 0.5% Standard"

The background information in Notice No. 4 makes it very clear that the most important issues surrounding classification of flavored malt beverages can be resolved by analyzing the plain language of federal statutes, some of which have existed for well over a century. TTB's particular focus is the Internal Revenue Code from which the "less than 0.5% alcohol by volume standard" is derived.

The Internal Revenue Code definition of "beer" in 26 U.S.C. § 5052 follows:

[T]he term "beer" means beer, ale, porter, stout, and other similar fermented beverages (including sake or similar products) of any name or description containing one-half of 1 percent or more of alcohol by volume, brewed or produced from malt, wholly or in part, or from any substitute therefore.

This broad language is designed to make clear that all types of fermented malt beverages are subject to federal excise taxes. Each beverage specified in § 5052 of the Internal Revenue Code is fermented from a base containing cereal grains.4

While the most recent generation of flavored malt beverages has gained significant attention in the marketplace, Notice No. 4 recognizes that flavored malt beverages have long existed within the beer and malt beverage category. Dozens of fruits, spices, and other food products are used as well as some flavors that may contain alcohol compounds as solvents or preservatives. Even if a flavor concentrate contains significant amounts of alcohol, the brewing process can be controlled to ensure that any distilled alcohol contained in added flavors is sufficiently diluted so that it does not contribute 0.5% or more of the alcohol by volume in the final product.

" In basic brewing, fermentation occurs when yeast is added to a combination of water, malted grains, and hops resulting in the conversion of fermentable sugars in the grains into alcohol, carbon dioxide, and other byproducts. Over many centuries, brewers have combined principles of the arts and sciences to control fermentation and to produce high-quality beers, ales, and other malt beverages. See generally, Hardwick, William A., Handbook of Brewing, New York, Marcel Dekker, Inc., 1995, pp. 37-52.

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The Federal Alcohol Administration Act definition of “malt beverage” also supports the historic distinction between beer and other alcohol beverages:

The term “malt beverage” means a beverage made by the alcoholic fermentation of an infusion or decoction, or combination of both, in potable brewing water, of malted barley with hops, or their parts, or their products, and with or without other malted cereals, and with or without the addition of unmalted or prepared cereals, other carbohydrates or products prepared therefrom, and with or without the addition of carbon dioxide, and with or without other wholesome products suitable for human food consumption.

This definition is part of a comprehensive and integrated statute dealing with labeling and advertising, the structure of the alcohol beverage distribution system, production methods, business practices, and other important governmental concerns.

Existing TTB regulations correctly assume that the public generally understands traditional beer styles, and that only unique products require special scrutiny. The FAA Act’s more technical definition of “malt beverage” is, therefore, the basis for various formal and informal ATF rulings concerning the actual brewing process. For example, an ATF publication includes a section entitled, “Minimum Requirements for Malt Beverage (Beer) Products”, which deals with brewing water and ratios of malt and hops per hundred barrels of beer.5 These requirements have been routinely enforced by TTB officials responsible for product classification and have been disseminated in agency publications and in public statements at various industry and government forums.

In addition to providing guidance on the basic brewing ingredients, TTB officers have reviewed thousands of label applications, statements of process, and other documentation dealing directly or indirectly with adjuncts and food products used in the

ATF Compliance Matters, 94-1, p. 2. The full text of the section reads as follows: Since 1970, the following minimum requirements have been used by ATF [now TTB] (and its predecessor agency) [Alcohol and Tobacco Tax Division] for products which will be marketed as malt beverages or beer:
1) Brewing Water: Materials used for treating brewing water have not been officially classified as brewing adjuncts by ATF. However, all materials used for this purpose must be unobjectionable under laws and regulations administered by the United States Food and Drug Administration.
2) Malt: A malt beverage (beer) must be made with at least 25 percent malt calculated as the percentage of malt (by weight) compared to the total dry weight of all ingredients which contribute fermentable extract to the base product.
3) Hops: A malt beverage (beer) must be made with at least 7.5 pounds of hops (or the equivalent thereof in hop extracts or hop oils) per 100 barrels (3100 gallons) of base product (beer, ale, etc.).

brewing process. TTB also has an existing memorandum of understanding and ongoing contacts with officials of the Food and Drug Administration to make certain that products added to beer and other malt beverages comply with food safety regulations.

TTB currently requires brewers to submit for agency review and approval a statement of process for "any fermented beverage which the brewer intends to produce and market under a name other than beer, ale, porter, stout, lager, or malt liquor."6 The statement of process is essentially a description of the product submitted in a format acceptable to TTB. It includes the designation of the product, materials used, the method of production, and the approximate alcohol content of the final product. The proposed new regulations requiring submission of a formula for certain non-traditional malt beverages constitute a similar and more formal approach to assist TTB officials in determining that a product meets the new standard. This is a reasonable means of addressing concerns expressed in TTB rulings, industry circulars, and public statements about flavored products introduced over the last several years.

Members of the Beer Institute have produced flavored malt beverages that meet the proposed standard. The products can be brewed to achieve the same taste and appearance as existing beverages. Assuming that the proposed TTB 0.5% standard becomes a final rule, brewers of existing products and any new entries into the marketplace will be able to comply with the statutes discussed above. All industry members would then be treated equitably under federal regulations governing the brewing process. Individual members of the Beer Institute may provide more detailed information about their respective products and the brewing process, which TTB has requested in Notice No. 4.

4. The Droposed standard for flavored malt beverages is based on longstanding federal and state benchmarks and addresses concerns articulated by state officials over the last two years.

The history of the 0.5% standard provides support for the current rulemaking and illuminates the challenges for policymakers in the absence of prompt federal action. Over the last 100 years, the "less than 0.5% alcohol by volume" standard has been

6 27 CFR § 25.67. Emphasis added.

adopted in a variety of different federal and state laws reflecting the fact that many beverage and food products contain small amounts of alcohol as a result of natural fermentation or from the addition of alcohol as a solvent or preservative.

In 1902, the Treasury Department formally determined that fermented liquor containing as much as one-half of 1 per centum of alcohol was taxable under federal law.7 In 1917, Congress adopted this classification in the so-called War Revenue Act.8

After ratification of the Eighteenth Amendment, the National Prohibition Act (commonly known as the Volstead Act) expressly included fermented and distilled alcohol "containing one-half of 1 percentum or more of alcohol by volume" as subject to federal control .

Disputes over state and federal definitions of intoxicating liquors erupted throughout the nation in the early days of Prohibition. A New York brewer initiated one of the first challenges to the federal prohibition laws. One of the issues raised was the conflict among various federal laws and regulations defining intoxicating liquors. The case reached the United States Supreme Court, which grappled with the definition of intoxicating liquors and noted cases on similar issues had been brought in at least 24 states.10 After discussing the chaotic situation, Justice Brandeis 'wrote:11

A test often used to determine whether a beverage is to be deemed intoxicating within the meaning of the liquor law is whether it contains one-half of one per cent. of alcohol by volume. A survey of the liquor laws of the states reveals that in sixteen states the test is either a list of enumerated beverages without regard to whether they contain any alcohol or the presence of any alcohol in a beverage regardless of quantity; in eighteen states it is the presence of as much as or more than one-half of 1 per cent. of alcohol; in six states, 1 per cent. of alcohol; in one state, the presence of the 'alcoholic principle'; and in two states, 2 per cent. of alcohol.

7 T.D. 514. See also, T.D. 2788 in 1919.
8 4O Stat. 311 (Comp. St. 1918, § 6144b).
NationalProhibition Act, Public Law No. 66, Title II, Section I, 41 Stat. 307, Codified at 27 U.S.C. Sec.4(1), Oct. 28, 1919.
10 Ruppert v. Caffey, U.S. Atty., et al., 251 U.S. 264, 282-284.
11 Ibid. @ 284-289.

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After an exhaustive survey of state laws and discussions of federal and state powers, Justice Brandeis concluded:12

It is, therefore, clear both that Congress might reasonably have considered some legislative definition of intoxicating liquor to be essential to effective enforcement of prohibition and also that the definition provided by the Volstead Act was not an arbitrary one.

Six months later another complex case dealing in part with the definition of intoxicating liquor" was decided by the Supreme Court on issues raised by conflicts between the Volstead Act and the laws of seven states.13 The Supreme Court decision included the following:14

While recognizing that there are limits beyond which Congress cannot go in treating beverages as within its power of enforcement, we think that those limits are not transcended by the provision of the Volstead Act (title 2, § 1), wherein liquors containing as much as one-half of 1 per cent. of alcohol by volume and fit for use for beverage purposes are treated as within that power.

Practical issues that the Supreme Court grappled with in 1920 have resurfaced in the current rulemaking, and the decisions offer important policy guidance even long after ratification of the 21St Amendment. The federal government is best situated to develop common product standards and to implement them with members of a regulated industry operating throughout the nation. States have generally responded to such standards in a manner that permits industry members to establish national markets for their products.

Over the last seven decades, the standards for beer and other malt beverages established by Congress have been widely incorporated into state laws and regulations, which are critical to the regulation of commerce in alcohol beverages under the 21st Amendment. Federal leadership in defining alcohol beverage categories is essential to an orderly and efficient national market and permits states to focus their efforts on licensing systems to ensure industry integrity, proper sales practices, and other important alcohol policy issues that are traditional areas of state concern and responsibility.

12 Ibid. @ 298-299.
13 Rhode Island v. Palmer, 40 S. Ct. 486, 1920.
14 Ibid. 488, citing Jacob Ruppert supra.

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Between July and November 2002, alcohol beverage regulators from at least sixteen states wrote letters in support of a federal standard for flavored malt beverages.15 Associations representing regulators in all fifty states and several other jurisdictions also endorsed TTB action to clarify the status of various flavored beverages for tax, distribution, and other regulatory purposes.16 Absent clear and expeditious action by TTB to formally adopt and implement the basic principles embodied in the proposed changes to 27 CFR Parts 7 and 25, brewers and other industry members face potential legal and legislative actions by individual states. The result would likely be a needless diversion of resources to address issues that have long been settled and a patchwork of laws and regulations that treat the same product differently from one state to another. Federal resources would also be strained in areas such as label and formula approval if brewers were required to produce unique products to comply with the laws of individual states.

Individual state officials have also articulated general support for a TTB rulemaking and a consistent federal standard for flavored malt beverages following TTB's informal proposal of the "less than 0.5% alcohol by volume standard", which was discussed publicly in various meetings between July and November, 2002. Due to unique features of their laws defining alcohol beverages, several states have already begun independent actions to ensure proper product classification and taxation of existing products. As of October 17, at least twenty-eight state alcohol beverage regulatory agencies had submitted formal comments in this rulemaking process. Some support the 0.5% standard. Others have indicated that it is consistent with or does not conflict with their respective state statutes and regulations.'7 As of the same date, only Georgia clearly indicated that its statutes would have to be changed. The change, however, would be

15 The following states wrote to ATF in support of a rulemaking process to address the issues detailed in Notice No. 4: Arkansas, Colorado, Delaware, Georgia, Iowa, Kansas, Kentucky, Louisiana, Minnesota, Missouri, Nebraska, New Mexico, Oregon, Texas, Virginia, and Washington.
16 Letter of August 5, 2002 from Murphy Painter, President of the National Conference of State Liquor Administrators to Bradley Buckles, Director of ATF; Letter of August 6, 2002 from James M. Sgueo in his capacity as Executive Secretary of the Joint Committee of the States to Arthur J. Libertucci, Assistant Director of ATF, Letter of September 26, 2002 from Jim Sgueo, Executive Director of the National Alcohol Beverage Control Association to Arthur J. Libertucci.
17 Arizona, Arkansas, California, Colorado, Florida, Idaho, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Missouri, Montana, Nebraska, North Carolina, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Virginia, West Virginia, Wisconsin, and Wyoming.

necessary regardless of the standard ultimately adopted by TTB.18 As of October 17, no state had specifically suggested or endorsed an alternative to the "less than 0.5% standard."

TTB is correct in suggesting that the "less than 0.5% alcohol by volume standard" is the best option to maintain consistency among existing federal and state statutes and regulations. While state officials must utilize their respective definitions of alcohol beverages, almost all of the states that have reviewed the issues can reconcile their statutes and regulations with the TTB proposal. That is not true of alternative standards that have been proposed.

Implementation of an alternative to the 0.5% standard proposed for flavored malt beverages would unravel the consensus and relative stability that have been achieved to date with respect to state statutes and regulations. The alternative discussed in Notice No. 4, a standard permitting a 5 1-49% blend of malt beverage and distilled alcohol would require many changes in existing state tax and regulatory systems or even worse, a return to state-federal conflicts and inconsistent regulation. It is a departure from the basic approach to malt beverage taxes, which are generally based on straightforward rates for a given volume of product. It would also lead to significant market disruptions because the three-tier distribution system and licensing statutes enacted in each state are based on the clear distinctions among alcohol beverage categories.

5. TTB's proposed standard will not adversely affect U.S. or international beverage producers or flavor manufacturers.

While the economic well being of certain sectors of the economy should not be a consideration in straightforward application of properly enacted federal statutes, this issue has been raised repeatedly during the comment period for this rulemaking. Often the comments are based on erroneous information that has been provided to retailers, notably the false threat that flavored malt beverages will disappear from the marketplace if the proposed TTB standard is finally adopted. Beverages in which distilled alcohol constitutes 0.5% or more of the alcohol in the final product could still be produced under

18 Letter from Georgia Department of Revenue, Alcohol and Tobacco Tax Division, June 18, 2003. Note also, that Arkansas officials indicated that a change in law might he needed, but expressed support for the 0.5% standard.

federal law, provided that they are sold, marketed, and taxed as distilled spirits. As discussed above, several major brewers have produced flavored malt beverages in the past that meet the “less than 0.5% standard,” and they are likely to do so in the future if a final rule is issued implementing the standard.

When ATF informally outlined its interpretation of the Internal Revenue Code in 2002, officials indicated that a rulemaking process would likely take up to two years to complete allowing industry members to reformulate their products in accordance with the law. Prudent manufacturers have already taken steps to accommodate potential changes.

6. Specific Comments on Text of Proposed Regulations

27 CFR § 25.55 Generally

As drafted, 27 CFR § 25.55(a)(2) is the critical provision to ascertain whether a beer or other malt beverage derives less than 0.5% alcohol by volume from the addition of flavors or other ingredients containing alcohol.19 The section is written to cover the addition of wine or any flavor or ingredient containing distilled alcohol at any point in the brewing process. It is, therefore, an adequate test to assist TTB in determining whether a flavored malt beverage meets the “less than 0.5% alcohol by volume standard.” The sections discussed below deal with specific aspects of the brewing process and with the addition of food products that do not contain alcohol. The Beer Institute believes that these sections should be deleted because they can be read to apply to a broad range of traditional malt beverages. That broader reading could lead to confusion among brewers and TTB officials in the future. It could also trigger submission of many more formulas based on factors that do not affect the tax classification of the products.

To further clarify the types of flavored malt beverages subject to the formula filing requirement, the following language from Notice No. 4 should be added to § 25.55 to indicate when a brewer is not required to file a formula:20

19 Taken together with the introductory sentence in § 25.55(a)(2) reads as follows: “You must file a formula with TTB if you intend to produce: Any fermented product to which taxpaid wine or any flavor or other ingredient containing alcohol will he added.”
20 68 Fed. Reg. 14299.

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You are not required to file a formula for traditional brewing processes such as pasteurization, filtration prior to bottling, filtration in lieu of pasteurization, centrifuging (for clarification), lagering, carbonation, and the like.

27 CFR 25.5 5(a)(1) – Formula Requirements

Subsection 25.55(a)(1) should be deleted because the description of various brewing processes is broad enough to cover most malt beverages. For example, most traditional beers are filtered, which changes their color and character.

27 CFR 25.55(a)(3) – Formula Requirements

The Beer Institute respectfully requests that this subsection be deleted. Many traditional malt beverages currently in the marketplace contain fruits, herbs, spices, or honey. The presence of these food products should not change the classification of beer, unless they contain a significant level of alcohol. As written, the proposed new section would substantially increase the number of formulas that TTB would have to review and approve with no clear evidence that it would assist agency officials in classifying products for tax purposes.

7. Proposed effective date in 27 CFR Part 25

The implementation or effective date provision of the final rule should also provide that the new standard applicable to flavored malt beverages, before they. can be taxed at the beer rate, is only to be applied prospectively from the date TTB chooses as the effective date. Furthermore, the effective date provision should also provide that for product removed for consumption or sale on or before the effective date of the new standard, flavored malt beverages produced pursuant to the guidelines of ATF Ruling 96-1 qualify for the beer tax rate. After the deadline for removal of flavored malt beverages under the current standard, an additional six months should be provided in the regulation to permit beer wholesalers to warehouse and sell existing inventories. To accomplish the above, an additional section of the final regulations should be drafted to provide certainty to all industry members with respect to the applicable tax rate, production regulations,

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and the status of product removed from a brewery prior to the effective date. Accordingly, we suggest an effective date provision as follows:

The effective date of these rules, including the standard for flavored malt beverages to qualitY for the beer tax rate, shall be [date certain three months after publication of the final rule]. Flavored malt beverages produced in accordance with ATF Ruling 96-1 and removed from a brewery on or before the effective date shall be subject to the beer tax rate.

Holders of federal basic permits to distribute malt beverages shall be allowed to store flavored malt beverages produced in accordance with ATF Ruling 96-1 and to resell them prior to [date certain six months from the effective date of the new regulations].

8. Conclusion

The Beer Institute respectfully submits these comments in support of the standards for flavored malt beverages proposed by TTB and urges expeditious action adopting the draft regulations as final rules with the technical revisions recommended herein. The Beer Institute or its members supporting these comments will be pleased to provide any further background information or answer any questions on matters relating to Notice No. 4.

Sincerely,

Jeff Becker

JGB:ajd/sah